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In The

# Supreme Court of the United States

October Term, 1992

NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA,

*Petitioner,*

vs.

LEONARD HELFAND and EILEEN HELFAND,

*Respondents.*

**On Petition For A Writ Of Certiorari To The California Court Of Appeal, First Appellate District, Division Four**

## PETITION FOR A WRIT OF CERTIORARI

HORVITZ & LEVY
ELLIS J. HORVITZ
PETER ABRAHAMS *
STEPHEN E. NORRIS
15760 Ventura Boulevard,
18th Floor
Encino, California
91436-3010
(818) 995-0800 and
(213) 872-0802

PETTIT & MARTIN
D. WAYNE JEFFRIES
SAUL D. BERCOVITCH
101 California Street,
35th Floor
San Francisco, California 94111
(415) 434-4000

ROBINSON & WOOD, INC.
ARCHIE S. ROBINSON
THOMAS R. FELLOWS
227 North First Street, Suite 300
San Jose, California 95113
(408) 298-7120

GIBSON, DUNN & CRUTCHER
THEODORE B. OLSON
THEODORE J. BOUTROUS, JR.
JEANNE M. HAUCH
1050 Connecticut Avenue, N.W.
Suite 900
Washington, D.C. 20036
(202) 955-8500

STROOCK & STROOCK & LAVAN
MICHAEL F. PERLIS
2029 Century Park East
Los Angeles, California
90067-3086
(213) 556-5800

*Attorneys for Petitioner*

* Counsel of Record

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

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## QUESTION PRESENTED

Does a state court lack subject matter jurisdiction to entertain a collateral attack on and nullify a final order of a United States Bankruptcy Court?

## LIST OF PARTIES AND RULE 29.1 LIST

The parties to the proceedings below were Petitioner National Union Fire Insurance Company of Pittsburgh, Pa. ("National Union") and Respondents Leonard and Eileen Helfand.

National Union's parent company is American International Group, Inc. ("AIG"). AIG is affiliated with The Starr Foundation, a charitable foundation, and C.V. Starr & Co. and Starr International Company, Inc., two privately held corporations. The Starr Foundation, C.V. Starr & Co., and Starr International Company, Inc. in the aggregate own approximately 22 percent of AIG's stock.

AIG has numerous wholly-owned subsidiaries. The AIG subsidiaries which are not wholly-owned by AIG and/or another AIG subsidiary are:

Transatlantic Holdings, Inc.

Nan Shan Life Insurance Company, Ltd. (Taiwan)

China America Insurance Company, Ltd.

China America International Insurance Company, Ltd. (Bermuda)

JI Accident & Fire Insurance Co. Ltd. (Japan)

The Philippine American Life Insurance Company (Philippines)

The Philippine American Assurance Company, Inc. (Philippines)

**LIST OF PARTIES AND**
**RULE 29.1 LIST – Continued**

Ticino Societa d'Assicurazioni Sulla Vita (Switzerland)

JI Accident & Fire Insurance Co. Ltd. is also a subsidiary of National Union.

National Union's other subsidiaries are wholly-owned.

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## PETITION FOR WRIT OF CERTIORARI

National Union Fire Insurance Company of Pittsburgh, Pa. ("National Union") respectfully petitions this Court for a writ of certiorari and requests that the Court summarily reverse the judgment of the California Court of Appeal, First Appellate District, Division Four.

This case involves an extraordinary and highly disruptive encroachment by a California court on the exclusive bankruptcy jurisdiction conferred by the Constitution and the Congress on the federal courts. The California Court of Appeal declared that despite a final order of the United States Bankruptcy Court approving an agreement between National Union and the debtor, Technical Equities Corporation ("Technical Equities") to cancel and revise coverage under the debtor's insurance policy, and finding that the agreement was "in the best interest of the estate and creditors," National Union was nonetheless required by state law to pay claims under the canceled portion of that policy.

Although the bankruptcy court's order has not been challenged in federal court by *anyone*, the court below reasoned that the bankruptcy court's cancellation of the debtor's insurance coverage was "arbitrary" and did not comport with federal bankruptcy procedural rules – rules that the bankruptcy court itself explicitly had found were satisfied. Moreover, the Court of Appeal found that the actions of National Union, authorized by the bankruptcy court, amounted to a breach of the state law implied covenant of good faith and fair dealing under the insurance contract. In subsequent state court insurance bad faith actions against National Union, the trial court

instructed the jury that the cancellation was "invalid, . . . a bankruptcy order to the contrary notwithstanding." The combined judgments against National Union in those bad faith actions exceed $170,000,000, including $43,000,000 in punitive damages.

Because the Court of Appeal's decision raises important questions of federal jurisdiction and amounts to "palpably clear . . . constitutional error," National Union requests that the Court grant a writ of certiorari and summarily reverse the portions of the decision which nullified the bankruptcy court's order. *Eaton v. City of Tulsa*, 415 U.S. 697, 707 (1974) (per curiam) (Rehnquist, J., dissenting); *see, e.g., Florida Dept. of Health & Rehabilitative Servs. v. Florida Nursing Home Ass'n*, 450 U.S. 147 (1981) (per curiam) (summarily reversing where "court below misapplied the prevailing standard for finding waiver of the State's immunity under the Eleventh Amendment").[1]

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[1] *See also Freeport-McMoran Inc. v. K N Energy*, 498 U.S. 426 (1991) (per curiam) (summarily reversing lower court holding that jurisdiction was lacking); *Mireles v. Waco*, 112 S. Ct. 286 (1991) (per curiam) (summarily reversing where lower court wrongly held that defendant judge was not immune from suit); *Commissioner v. McCoy*, 484 U.S. 3 (1987) (per curiam) (summarily reversing tax case because Court of Appeals had no statutory jurisdiction); *Iron Arrow Honor Soc'y v. Heckler*, 464 U.S. 67 (1983) (per curiam) (summarily reversing on ground that Court of Appeals lacked jurisdiction because case was moot).

## OPINION AND ORDERS BELOW

The judgment of the trial court is unreported and is reprinted in the appendix at 53a-104a.

The opinion and judgment of the California Court of Appeal is reported at 10 Cal. App. 4th 869, 13 Cal. Rptr. 2d 295 and is reprinted in the appendix at 1a-52a. The order of the California Court of Appeal denying National Union's petition for rehearing is unreported and is reprinted in the appendix at 106a.

The order of the California Supreme Court denying review is unreported and is reprinted in the appendix at 105a.

## JURISDICTION

The judgment of the Court of Appeal was entered on October 28, 1992. That court denied a timely petition for rehearing on November 30, 1992. On February 11, 1993, the California Supreme Court denied a timely petition for review. On May 5, 1993, Justice O'Connor ordered that the time for filing a petition for a writ of certiorari be extended to and including June 11, 1993. This Court has jurisdiction over this case under 28 United States Code section 1257(a) (West 1988).

## CONSTITUTIONAL PROVISIONS, STATUTES AND RULES INVOLVED

This case principally involves the following provisions of the United States Constitution, federal statutes and rules:

1. The Bankruptcy Clause of the Constitution of the United States, Article I, Section 8, Clause 4, provides:

> The Congress shall have Power To . . . establish . . . uniform Laws on the subject of Bankruptcies throughout the United States. . . .

2. 28 United States Code sections 1334(a), (b) and (d) (West Supp. 1993) provide:

> (a) Except as provided in subsection (b) of this section, the district courts shall have original and exclusive jurisdiction of all cases under title 11.
>
> (b) Notwithstanding any act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.
>
> . . . .
>
> (d) The district court in which a case under title 11 is commenced or is pending shall have exclusive jurisdiction of all of the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate.

3. Federal Rules of Civil Procedure 60(b) provides in pertinent part:

> (b) Mistakes; Inadvertence; Excusable Neglect; Newly Discovered Evidence; Fraud, Etc.
>
> On motion and upon such terms as are just, the court may relieve a party or a party's legal representative from a final judgment, order, or

proceeding for the following reasons: (1) mistake, inadvertence, surprise, or excusable neglect; (2) newly discovered evidence which by due diligence could not have been discovered in time to move for a new trial under Rule 59(b); (3) fraud (whether heretofore denominated intrinsic or extrinsic), misrepresentation, or other misconduct of an adverse party; (4) the judgment is void; (5) the judgment has been satisfied, released, or discharged, or a prior judgment upon which it is based has been reversed or otherwise vacated, or it is no longer equitable that the judgment should have prospective application; or (6) any other reason justifying relief from the operation of the judgment. The motion shall be made within a reasonable time, and for reasons (1), (2), and (3) not more than one year after the judgment, order, or proceeding was entered or taken. A motion under this subdivision (b) does not affect the finality of a judgment or suspend its operation. This rule does not limit the power of a court to entertain an independent action to relieve a party from a judgment, order, or proceeding, or to grant relief to a defendant not actually personally notified as provided in Title 28, U.S.C. § 1655, or to set aside a judgment for fraud upon the court. . . .

4. Federal Bankruptcy Rule 9024 provides:

Relief from Judgment or Order

Rule 60 F.R.Civ.P. applies in cases under the Code except that (1) a motion to reopen a case under the Code or for the reconsideration of an order allowing or disallowing a claim against the estate entered without a contest is not subject to the one year limitation prescribed in Rule

60(b), (2) a complaint to revoke a discharge in a chapter 7 liquidation case may be filed only within the time allowed by § 727(e) of the Code, and (3) a complaint to revoke an order confirming a plan may be filed only within the time allowed by § 1144, § 1230, or § 1330.

## STATEMENT OF THE CASE

### A. The Federal Bankruptcy Proceedings

On August 5, 1984, National Union issued a three-year insurance policy to Technical Equities, a financial services corporation, that provided the company's directors and officers with $10,000,000 in coverage for claims made in each of the policy years from August 1, 1984 through August 1, 1987. Appendix to Petition for a Writ of Certiorari ("App.") at 2a-3a. The policy included a provision that gave both National Union and Technical Equities the right to cancel the policy upon written notice to the other. App. at 30a.

In February 1986, during the second year of the policy's three-year term, Technical Equities filed a petition for reorganization under Chapter 11 of the United States Bankruptcy Code. App. at 27a. Thereafter, Technical Equities' investors, including respondents in this case, filed hundreds of claims for intentional and negligent misrepresentation against the company's pre-bankruptcy directors and officers.[2] Those claims threatened to exhaust the

[2] This declaratory relief action is part of coordinated proceedings in state court that consist of the numerous lawsuits filed following Technical Equities' financial collapse. *See In re*

liability limits of the policy, leaving no coverage for the newly constituted board of directors of the company as debtor-in-possession. To resolve this dilemma, the new board authorized its chairman to negotiate with National Union to obtain $5,000,000 in directors and officers liability coverage for a twelve-month period " 'if no additional premiums need be paid.' " *See* App. at 28a.

Negotiations subsequently produced a carefully crafted agreement between National Union and Technical Equities.[3] In return for the cancellation of the existing policy, effective July 13, 1986 (within the second policy year), National Union agreed to issue a new $5,000,000 policy to cover claims against the members of the new board of directors based on post-bankruptcy acts, App. at 196a-97a, and to require no additional premiums from Technical Equities for such continued coverage. The premiums for the new policy were equal to the unearned premium on the original policy, so nothing was owed by either Technical Equities or National Union. App. at 196a. A portion of the unearned premium also paid for extended coverage under the original policy, i.e., any post-cancellation claims based on pre-bankruptcy acts would be deemed made prior to the July 13 cancellation subject to the second-year policy liability limits. *Id.*

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*Technical Equities Litig.*, Master File No. 1991, Santa Clara County Superior Court No. 600306.

[3] National Union initially notified Technical Equities that it was exercising its right to unilaterally cancel upon written notice as provided for in the policy. App. at 27a. That cancellation was never consummated. Instead, the parties entered into the consensual agreement to cancel and replace the policy which was approved by the bankruptcy court.

On July 28, 1986, the bankruptcy court granted Technical Equities' motion for approval of the agreement. The notice of the motion, which was served on each pre-bankruptcy director and officer, stated, inter alia, that "[Technical Equities] shall agree that the Policy has been canceled effective July 13, 1986 . . . . " App. at 196a.

The bankruptcy court explicitly found that adequate notice had been "provided to all parties entitled thereto," App. at 199a, and that the agreement was "in the best interest of the estate and creditors." App. at 200a. The Court of Appeal in this case acknowledged that "[t]he bankruptcy order approving the compromise is final – no one appealed from it or brought a direct attack seeking relief from the order" in the federal courts. App. at 33a.

### B. The California State Court Proceedings

#### 1. The Trial Court Decision

Respondents Leonard and Eileen Helfand, two Technical Equities investors, brought this action in state court on November 10, 1986, to obtain a declaration of the amount of coverage available under the original policy.[4] On May 12, 1988, almost two years after the bankruptcy court approved the changes in the debtor's insurance

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[4] In their original complaint, filed four months after the bankruptcy court approved the cancellation, respondents sought only a declaration that defense costs were payable in addition to policy limits. They did not dispute National Union's contention that only the $10,000,000 liability limits under the second policy year were available to satisfy claims against the directors and officers arising out of the financial collapse of Technical Equities.

coverage, respondents amended their complaint to seek a declaration that, despite the bankruptcy court's order, the third year of the original policy remained in effect and therefore provided an additional $10,000,000 in coverage for claims made against the pre-bankruptcy directors and officers during that third year. National Union objected, contending that the federal bankruptcy court had exclusive jurisdiction respecting the changes it had approved in the debtor's insurance coverage, that the bankruptcy order could not be collaterally attacked in state court and that the order conclusively foreclosed as a jurisdictional matter respondents' contention that claims made in the third policy year were covered under the cancelled portion of the policy. App. at 107a-35a.

The trial court rejected these contentions. It ruled that it "is not bound by the Bankruptcy Court's . . . order, even if it purports to authorize the cancellation." App. at 81a.[5] According to the trial court, the cancellation and its approval by the bankruptcy court were invalid because

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[5] The trial court relied on its holdings in this case as authority for its jury instructions in *McLaughlin v. National Union*, A05115 (Cal. Ct. App.) (appeal pending), one of the insurance bad faith actions against National Union in the coordinated state court proceedings. "[T]he trial court instructed the jury: 'Cancellation of the third year of the D&O policy was invalid, *and had no effect on plaintiffs herein, a bankruptcy order to the contrary notwithstanding.*'" App. at 29a-30a, 201a (emphasis added). The combined bad faith judgments against National Union in *McLaughlin* and a subsequent insurance bad faith action in which the trial court gave collateral estoppel effect to the jury verdicts in *McLaughlin* (*Abelson v. National Union*, A05393 (Cal. Ct. App.) (appeal pending)) exceed $170,000,000, including $43,000,000 in punitive damages.

the notice of the bankruptcy court hearing, although served on each director and officer and found sufficient by the bankruptcy court under the bankruptcy rules, was substantively inadequate, in violation of the Due Process Clause. App. at 75a-81a. The trial court found the notice was unconstitutional because it "did not suggest that ten million dollars of insurance coverage would be lost for claims made during the third year, . . . it gave the directors and officers only a few days to respond . . . and [it] was addressed 'To All Interested Parties:' although there was certainly no difficulty in including the names of all the officers and directors in the salutation." App. at 74a. The court also ruled that the bankruptcy court's order did not bind respondents (claimants against the officers and directors) because respondents' interests were not adequately represented by any of the other parties present at the bankruptcy court hearing. App. at 81a-83a. In addition, the court held that because the cancellation was invalid and the policy remained in effect, there was no unearned premium that could be used to purchase the successor policy. According to the court, the post-petition directors and officers were not entitled to coverage under the successor policy unless Technical Equities, the debtor-in-possession, paid National Union a premium of $1,634. App. at 88a.

The effect of the California trial court's ruling was to nullify the bankruptcy court's order approving the agreement that had been reached between National Union and Technical Equities. The court not only held that an additional $10,000,000 in coverage under the original policy was available to pay claims made against the pre-bankruptcy directors and officers in the third policy year, it

also invalidated the provisions of the bankruptcy agreement relating to the successor policy, thereby stripping the new directors of coverage under that policy that had been authorized and approved by the bankruptcy court. *See* App. at 87a-88a.[6]

### 2. The California Court Of Appeal's Decision

National Union appealed from the trial court's judgment, insisting that the federal bankruptcy court had exclusive jurisdiction over the changes that it had approved in the debtor's insurance coverage and that its order was therefore constitutionally binding on the California courts and immune from collateral attack in state court. App. at 136a-73a. On October 28, 1992, the California Court of Appeal affirmed the trial court's holding that it was not bound by the bankruptcy court's order and that coverage was available under the canceled portion of

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[6] Following entry of the trial court's judgment, National Union filed an action in federal court for an order enjoining further state court proceedings under 28 United States Code section 2283 (West 1990) and 28 United States Code section 1651 (West 1989), which empower a United States District Court to enjoin proceedings in a state court when necessary to protect or effectuate its judgments. The District Court denied the requested relief on the ground National Union's federal constitutional arguments were already pending before the California Court of Appeal in this case. The United States Court of Appeals for the Ninth Circuit summarily affirmed. This Court has noted that "[c]hallenges to the correctness of a state court's determination as to the conclusive effect of a federal judgment must be pursued by way of appeal through the state-court system and certiorari from this Court." *Parsons Steel, Inc. v. First Ala. Bank*, 474 U.S. 518, 525 (1986).

the insurance policy despite the agreement canceling it that had been approved by the bankruptcy court. App. at 27a-51a.

Although the Court of Appeal purported "not [to] classify this lawsuit as a collateral attack on a bankruptcy order," it held that an additional $10,000,000 in coverage was available under the segment of the policy that had been cancelled by the bankruptcy court's order if "National Union did not act in good faith in seeking cancellation" from the bankruptcy court. App. at 34a. The Court of Appeal affirmed the trial court's ruling that, despite the bankruptcy court's explicit finding that adequate notice had been provided pursuant to the bankruptcy rules, the bankruptcy court order violated due process because it did not provide adequate notice to the directors and officers of Technical Equities who had assigned their claims against National Union to respondents. App. at 36a-41a. It also held that respondents, as "non-parties" to the bankruptcy agreement between National Union and Technical Equities who did not personally participate in the hearing on the motion, could not be bound by the bankruptcy order approving the agreement. App. at 42a-46a.

On the basis of its conclusion that the California courts had jurisdiction to sweep aside the bankruptcy order and apply state law, the Court of Appeal declared that National Union's participation in the cancellation of the policy in the federal bankruptcy proceedings constituted a violation of the implied "covenant of good faith and fair dealing" read into insurance contracts by the California courts. App. at 51a. The Court of Appeal acknowledged that the cancellation of the policy made

"sense" as to Technical Equities' creditors "because it favored the debtor's continued existence." App. at 43a. But the court held that the cancellation was nonetheless invalid because it ignored the rights of Technical Equities' former directors and officers and "solely benefitted National Union and Technical Equities, DIP [debtor-in-possession]." App. at 51a.

The court concluded that the cancellation of the policy during bankruptcy was "arbitrary," App. at 50a, and that an "arbitrary cancellation is a breach of the covenant of good faith and fair dealing," App. at 51a, even though (i) National Union had an express, unilateral right to cancel the policy, (ii) it canceled the policy by agreement with the owner of and named insured under the policy, (iii) the unearned premium had been used to purchase coverage for the new directors and officers, and (iv) the bankruptcy court had held that cancellation was consistent with federal bankruptcy law and its obligation to reorganize Technical Equities.

National Union filed a petition for rehearing asking the Court of Appeal to delete its conclusion that National Union had violated the implied covenant of good faith and fair dealing by participating in the bankruptcy agreement canceling the policy. App. at 174a-76a. It urged the Court of Appeal to "avoid . . . a decision [infringing] on the exclusive jurisdiction of a federal court and [violating] principles of federal-state comity," App. at 174a, and that "any holding that the bankruptcy court sanctioned a bad faith cancellation necessarily constitutes a collateral attack on the bankruptcy order." App. at 175a. On November 30, 1992, the Court of Appeal summarily denied the petition for rehearing. App. at 106a.

National Union filed a petition for review in the California Supreme Court, raising the same federal questions it had raised before the Court of Appeal. App. at 177a-93a. The California Supreme Court summarily denied the petition for review on February 11, 1993, with one justice voting to grant review. App. at 105a.

## REASON FOR GRANTING THE WRIT

**The California Courts Lacked Subject Matter Jurisdiction As A Matter Of Federal Law To Entertain A Collateral Attack On The Bankruptcy Court Order Because The Validity Of A Final Order Permitting A Debtor In Bankruptcy To Amend, Modify Or Cancel A Contract Falls Within The Exclusive Jurisdiction Of The Federal Courts**

The California courts clearly lacked subject matter jurisdiction to determine whether the National Union policy had been validly cancelled. Under the Bankruptcy Clause of the Constitution of the United States and the statutes enacted by Congress thereunder, the federal courts have exclusive jurisdiction over that issue. This Court should therefore grant a writ of certiorari and summarily reverse that portion of the Court of Appeal's decision that nullified the bankruptcy court's order.

The Constitution expressly confers on Congress the "[p]ower . . . [t]o establish . . . uniform laws on the subject of bankruptcies throughout the United States." U.S. Const., art. I, § 8, cl. 4. Pursuant to this authority, Congress has promulgated the United States Bankruptcy Code, *see* 11 U.S.C. § 101, et seq. (West 1988); created the United States Bankruptcy Courts, *see* 28 U.S.C. §§ 157-58 (West 1988); vested exclusive jurisdiction in the federal

courts to enforce the bankruptcy laws and to hear bankruptcy cases, *see, e.g.*, 28 U.S.C. § 1334(a) (West 1988) ("the district courts shall have original and exclusive jurisdiction of all cases under title 11"); 28 U.S.C. § 1334(d) ("The district court in which a case under Title 11 is commenced or is pending shall have exclusive jurisdiction of all of the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate"); and established detailed and comprehensive procedural rules to govern bankruptcy proceedings and litigation. *See, e.g.*, Federal Bankruptcy Rules.

Congress' exclusive grant of jurisdiction to the federal courts plainly precludes state courts from asserting jurisdiction over matters that are within the province of, and have been determined by, the federal bankruptcy courts.[7] As this court has held, "[t]he Constitution grants Congress exclusive power to regulate bankruptcy and under this power Congress can limit the jurisdiction

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[7] Proceedings in bankruptcy are proceedings in rem, *In re Met-L-Wood Corp.*, 861 F.2d 1012, 1017 (7th Cir. 1988), *cert. denied sub nom. Gekas v. Pipin*, 490 U.S. 1006 (1989); *Chapel v. First Trust Co.*, 30 F. Supp. 765, 766 (E.D. Wis. 1940), and a debtor's insurance policies, which are part of the estate, are within the bankruptcy court's exclusive in rem jurisdiction, *MacArthur Co. v. Johns-Manville Corp.*, 837 F.2d 89, 91 (2d Cir.), *cert. denied*, 488 U.S. 868 (1988); *In re Minoco Group of Cos.*, 799 F.2d 517, 519 (9th Cir. 1986). A bankruptcy court clearly has the power to make orders regarding a debtor's property that favor its "continued existence," *see* App. at 43a, including modification and termination of the debtor's insurance and other contracts. "In fact, the very essence of bankruptcy laws is the modification or impairment of contractual obligations." *In re Webber*, 674 F.2d 796, 802 (9th Cir. 1982).

which courts, state or federal, can exercise over the person and property of a debtor who duly invokes the bankruptcy law." *Kalb v. Feuerstein*, 308 U.S. 433, 439 (1940). In *Kalb*, a state court had rejected the argument that it lacked subject matter jurisdiction to foreclose on property that fell within the federal bankruptcy jurisdiction. The Court held that Congress' vesting of exclusive jurisdiction in the federal courts pursuant to the Bankruptcy Clause "oust[ed] the jurisdiction of the State court," rendering the state judgment "not merely erroneous but . . . beyond [the state court's] power, void." *Id.* at 438. The "States cannot, in the exercise of control over local laws and practice, vest State courts with power to violate the supreme law of the land." *Id.*

This Court recently reiterated that the holding in *Kalb* rested "on Congress' exclusive right to regulate bankruptcy, which gave it the power to vest jurisdiction over bankruptcy proceedings exclusively in one forum and to withdraw that jurisdiction from all other forums, and Congress' statutory exercise of that right." *International Longshoremen's Ass'n v. Davis*, 476 U.S. 380, 393 n.11 (1986) (a case "strikingly similar" to *Kalb*; applying *Kalb* and finding that jurisdictional pre-emption of state law under the National Labor Relations Act meant that "the state court had *no power* to adjudicate the subject matter of the case") (emphasis added) *Id.* at 393 & n.11; *see also United States v. Williams*, 341 U.S. 58, 67 (1951) (because federal government, "in the exercise of its plenary power over bankruptcy had ousted state courts of all independent power over farmer bankrupts . . . any subsequent orders in the state courts were void") (citing *Kalb*); *Marine Harbor Properties, Inc. v. Manufacturer's Trust Co.*, 317 U.S. 78, 83

(1942) ("The federal bankruptcy power is, of course, paramount and supreme and may be so exercised by Congress as to exclude every competing or conflicting proceeding in state or federal tribunals") (citing *Kalb*); cf. *White v. Schloerb*, 178 U.S. 542, 547 (1900) (" 'After an adjudication in bankruptcy an action of replevin in a state court cannot be commenced and maintained against the bankrupt to recover property in the possession of and claimed by the bankrupt at the time of that adjudication, and in the possession of a referee in bankruptcy at the time when the action of replevin is begun' "); *In re South Beardstown Drainage & Levee Dist.*, 125 F.2d 13, 15 (7th Cir. 1941) ("The Constitutional provision which gave to Congress the power to enact uniform bankruptcy legislation made the Federal Bankruptcy Law, the exclusive and dominant law of the land on the subject of bankruptcy. As a corollary, it necessitated a recognition of the paramount and exclusive jurisdiction of the Federal courts in matters of bankruptcy, when that jurisdiction is properly invoked").

The federal courts of appeals have recognized that "[t]he ability collaterally to attack bankruptcy petitions in the state courts would . . . threaten the uniformity of federal bankruptcy law, a uniformity required by the Constitution." *Gonzales v. Parks*, 830 F.2d 1033, 1035 (9th Cir. 1987). Thus, in *Gonzales*, the Ninth Circuit held that it would violate the Bankruptcy Clause of the Constitution to permit collateral attacks on federal bankruptcy orders in state court. In that case, a creditor filed a tort action in California state court, alleging that a debtor's prior federal bankruptcy filing constituted a tortious abuse of process, and the state court entered judgment for the creditor. 830 F.2d at 1033-34. The debtor then sought relief

from the state court judgment in the federal bankruptcy court, which vacated the state judgment.

The Ninth Circuit affirmed, holding that the state courts lacked subject matter jurisdiction to hear a claim relating to a federal bankruptcy petition, because "[f]ilings of bankruptcy petitions are a matter of exclusive federal jurisdiction." *Id.* at 1035. It declared that state courts simply may not intervene, at any stage, in matters that fall within the federal bankruptcy jurisdiction: "State courts are not authorized to determine whether a person's claim for relief under a federal law, in a federal court, and within that court's exclusive jurisdiction, is an appropriate one. Such an exercise of authority would be inconsistent with and subvert the exclusive jurisdiction of the federal courts by allowing state courts to create their own standards as to when persons may properly seek relief in cases Congress has specifically precluded those courts from adjudicating." *Id.*[8] Put slightly differently,

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[8] *See also Gene R. Smith Corp. v. Terry's Tractor, Inc.*, 209 Cal. App. 3d 951, 257 Cal. Rptr. 598 (1989), *cert. denied*, 494 U.S. 1016 (1990) (dismissing because exclusive federal bankruptcy jurisdiction precluded collateral challenge); *Idell v. Goodman*, 224 Cal. App. 3d 262, 273 Cal. Rptr. 605 (1990) (malicious prosecution action preempted by federal bankruptcy law); *Cassidy v. Kentner*, 600 N.E.2d 1200, 1201 (Ill. Ct. App. 1992) (dismissing because "[i]t is clear that this court lacks any power to review the correctness of the rulings of a federal bankruptcy court"); *Prososki v. Commercial Nat'l Bank & Trust Co.*, 365 N.W.2d 427, 429 (Neb. 1985) (appropriate procedure to test bankruptcy court action is by appeal to federal district court and not by filing independent action in state court); *Reldan Trading Corp. v. ABC Films, Inc.*, 196 N.Y.S.2d 270 (N.Y. Sup. Ct. 1959) (dismissing action on grounds that federal bankruptcy court had jurisdiction).

state courts lack the power to disregard and must fully respect a bankruptcy court order. *Stoll v. Gottlieb*, 305 U.S. 165, 170-71 (1938).

The availability of a panoply of post-judgment remedies from final bankruptcy orders in federal court confirms that Congress did not intend – and the Constitution will not permit – state courts to assert jurisdiction to entertain collateral challenges, of any kind or under any circumstances, to federal orders that fall within the exclusive federal bankruptcy jurisdiction. *See Gonzales*, 830 F.2d at 1035 ("That Congress' grant to the federal courts of exclusive jurisdiction over bankruptcy petitions precludes collateral attacks . . . in state court is supported by the fact that remedies have been made available in federal court"). The Federal Bankruptcy Rules incorporate by reference the post-judgment remedies afforded by the Federal Rules of Civil Procedure. *See, e.g.*, Fed. Bank. R. 9023 (applying Rule 59(e) of Fed. R. Civ. P. authorizing motions to alter or amend the judgment to bankruptcy proceedings); *see also Pioneer Inv. Servs. Co. v. Brunswick Assocs. Ltd. Partnership*, 113 S. Ct. 1489 (1993) (creditor entitled to relief pursuant to Fed. Bank. R. 9006(b)(1) from its attorney's failure to file claim within bar date where the notice of the bar date was inconspicuously placed in a notice regarding a creditors' meeting). Moreover, an aggrieved creditor may appeal a final bankruptcy court order, first to a federal district court and then to a federal court of appeals, 28 U.S.C. § 158 (West 1988), and a non-party whose interests are potentially at stake may intervene during the federal appellate proceedings to protect those interests. *See* Fed. Bank. R. 2018(a) (court may permit any interested party to intervene); *Yniguez v. State of*

*Arizona*, 939 F.2d 727, 731-32 (9th Cir. 1991) (person who did not participate below may intervene on appeal where person's interests not adequately represented by other parties).

Further, where, as here, persons claim that they did not receive notice sufficient to permit them fully and adequately to participate in the federal bankruptcy court proceedings prior to the expiration of the time for filing an appeal, a federal remedy exists under Federal Rules of Civil Procedure 60(b), as incorporated by Rule 9024 of the Federal Bankruptcy Rules. *See, e.g., In re Barnes*, 969 F.2d 526, 527 (7th Cir. 1992) ("The usual motion to reopen a proceeding in which the judgment has become final is a collateral attack on the judgment and is therefore subject, in bankruptcy as in other federal cases, to the strict limitations of Rule 60(b)"); *In re Edwards*, 962 F.2d 641, 644 (7th Cir. 1992) ("collateral relief from an order approving a bankruptcy sale is governed by the standards of Rule 60(b)"); *In re Tek-Aids Indus., Inc.*, 145 Bankr. 253, 258 (N.D. Ill. 1992) (granting Rule 60(b) relief from final bankruptcy judgment because creditors did not receive notice).

To permit subsequent collateral attacks in state court on federal bankruptcy court orders would seriously undermine the paramount principle of finality in federal bankruptcy law. As the First Circuit has explained: "In order efficiently to administer the estate, a trustee's court-approved settlement must have finality, and settling parties must be assured that those the trustee represents will not relitigate settled claims." *In re Medomak Canning*, 922 F.2d 895, 901 (1st Cir. 1990). Thus, "[a] strong interest to achieve finality pervades Chapter 11 arrangements." *Oneida Motor Freight v. United Jersey Bank*,

848 F.2d 414, 417 (3d Cir.), *cert. denied*, 488 U.S. 967 (1988); *see also Edwards*, 962 F.2d at 645 (discussing the "strong policy of finality of bankruptcy sales"); *Hendrick v. Avent*, 891 F.2d 583, 587 n.9 (5th Cir.), *cert. denied*, 498 U.S. 819 (1990) (recognizing "the important interest in the finality of judgments in a bankruptcy case.").

To ensure finality, the federal courts of appeals have established strict limits on the power of even the federal courts to set aside final bankruptcy court orders. Such complaints generally must be made, if at all, pursuant to Rule 60(b), subject to rigorous procedural requirements. *Edwards*, 962 F.2d at 642, 645 (creditor who claimed lack of notice of bankruptcy sale barred from challenging bankruptcy court's order, except by proper Rule 60(b) motion); *Hendrick v. Avent*, 891 F.2d at 585-87 (creditor who alleged it was the victim of misrepresentations during bankruptcy proceedings that resulted in sale of property was prohibited from bringing separate action because Rule 60(b) is the only proper method of attacking final judgment); *Sure-Snap Corp. v. State Street Bank & Trust Co.*, 948 F.2d 869 (2d Cir. 1991) (separate tort suit relating to bankruptcy disposition impermissible).

Respondents in this case ignored the remedies available to them in federal court and instead sought out a more receptive forum in state court, where the need to balance the "property rights on both sides of the equation," *Edwards*, 962 F.2d at 645, and the unique purposes and policies of the federal bankruptcy law would not constrain the inquiry.[9] But the California courts had no

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[9] A person dissatisfied by a bankruptcy court ruling is more likely to find a sympathetic ear in state than in federal

jurisdiction either to evaluate the substantive merits of the agreement between the bankruptcy debtor and National Union or to question the procedural fairness of the federal proceedings relating to a matter that falls within the exclusive jurisdiction of the federal courts.[10]

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court. As this case illustrates, the state and federal courts will frequently be concerned with vindicating different rights. In some cases, the conflict between the respective concerns of the state and federal courts can be dramatic, and the incentive to disregard a bankruptcy court order overwhelming. In *Kamstra v. Kent County Treasurer*, 51 B.R. 826 (1985), for example, the bankruptcy court granted the trustee's request to subordinate city and county tax liens on the debtor's property to the estate's administrative expenses. The effect of the order was to totally extinguish the liens. The bankruptcy court rejected the city's and county's contention that it was impermissibly intruding on their interest in revenues in violation of the Tenth Amendment. It explained that the authority to subordinate the liens was included within its "power to discharge the debtor from his contracts and legal liabilities as well as to distribute his property." A state court, which depends for its continued functioning on tax revenues, would have doubtless given more credence to the city's and county's position.

[10] The Court of Appeal claimed it was not sanctioning a collateral attack on the bankruptcy court order because that order – discontinuing one insurance policy and installing another – did not "impact or determine rights as between the insurer and its insureds." App. at 33a, *see also* App. at 35a. But the bankruptcy order plainly determined such rights. By approving the agreement between the debtor and National Union canceling the policy during the second policy year, the bankruptcy court necessarily determined the rights of the debtor's former directors and officers in the proceeds of the third policy year. Moreover, unless the agreement relieved National Union of its obligations under the third policy year, it would have never issued the successor policy: there would have

The California Court of Appeal's determination henceforth to entertain collateral attacks on final bankruptcy court orders has enormous practical significance. Once a petition seeking protection under Chapter 11 of the Bankruptcy Code is filed, "keeping the bankrupt in operation is difficult." *In re Met-L-Wood Corp.*, 861 F.2d at 1017. A bankruptcy court must have the ability to approve *binding* agreements with third parties for services and supplies necessary to sustain the debtor's continued existence. *Id.* at 1019. One of the first challenges faced by a corporate debtor is obtaining insurance coverage for its directors and officers. Without such coverage, the corporation is unlikely to attract directors and officers willing to guide the corporation through reorganization. *In re Minoco Group of Cos.*, 799 F.2d at 518; *In re Baldwin-United Corp.*, 43 B.R. 443, 447 (Bankr. S.D. Ohio 1984) (discussing importance of insuring that debtors can obtain adequate insurance for post-petition directors and officers).

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been no unearned premium to return and therefore no consideration for that policy.

Further, the Court of Appeal found that the agreement between the debtor and National Union which was approved by the bankruptcy court was "arbitrary," concluded that National Union's participation in the bankruptcy proceedings, in and of itself, constituted a breach of the state law implied covenant of good faith and fair dealing, and approved the trial court's conclusion that no coverage was available under the successor policy unless the debtor-in-possession paid an additional premium, even though the bankruptcy court had authorized the issuance of the policy without the payment of a premium. If these rulings do not constitute a collateral attack, and an impermissible interference with a federal court judgment, it is hard to imagine what would.

Here, the bankruptcy court obtained coverage for the debtor's newly constituted board of directors by approving an agreement that called for the cancellation of the existing policy and using the unearned premium to purchase a policy covering the new board. If state courts were empowered to set aside such orders (and find in addition that insurers that rely on them can violate a state law implied covenant of good faith and fair dealing), no insurer would agree to cancel a debtor's policy in return for the issuance of a new policy, even if a bankruptcy court found the new policy was essential to the debtor's continued existence. Moreover, the Court of Appeal's decision in this case is not limited to bankruptcy orders relating to insurance policies but rather opens up all orders disposing of property to potential collateral challenge in state court if it can be argued that the order gives insufficient consideration to the interests of third persons.

This Court should grant the writ and summarily reverse. First, the California Court of Appeal's decision is manifestly wrong and outside that court's jurisdiction. Second, the question whether state courts may exercise collateral review of a federal judgment where Congress has declined to vest such courts with jurisdiction to consider directly the subject matter of the federal claims is important, substantial and recurring. Indeed, if allowed to stand, the published opinion of a Court of Appeal in the Nation's largest State in this case no doubt will materially frustrate and intrude on the exclusive jurisdiction of the federal courts to resolve bankruptcy matters and will defeat the uniformity of federal bankruptcy law that is explicitly directed by the Bankruptcy Clause of the Constitution.

## CONCLUSION

For the foregoing reasons, the petition for writ of certiorari should be granted and the portion of the judgment of the California Court of Appeal that nullified the bankruptcy court's order should be summarily reversed.

Respectfully submitted,

HORVITZ & LEVY
ELLIS J. HORVITZ
PETER ABRAHAMS *
STEPHEN E. NORRIS
GIBSON, DUNN & CRUTCHER
THEODORE B. OLSON
THEODORE J. BOUTROUS, JR.
JEANNE M. HAUCH
PETTIT & MARTIN
D. WAYNE JEFFRIES
SAUL D. BERCOVITCH
STROOCK & STROOCK & LAVAN
MICHAEL F. PERLIS
ROBINSON & WOOD, INC.
ARCHIE S. ROBINSON
THOMAS R. FELLOWS

*Counsel for Petitioner*
*National Union Fire Insurance*
*Company of Pittsburgh, PA*

* Counsel of Record